

ORIGINAL



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NEW APPLICATION

BEFORE THE ARIZONA CORPORATION COMMISSION

COMMISSIONERS

BOB STUMP, Chairman  
GARY PIERCE  
BRENDA BURNS  
BOB BURNS  
SUSAN BITTER SMITH

RECEIVED  
AZ CORP COMMISSION  
DOCKET CONTROL

2013 NOV 27 PM 3 12

IN THE MATTER OF THE APPLICATION OF  
SOUTHWESTERN TELEPHONE COMPANY,  
AN ARIZONA CORPORATION, FOR A  
HEARING TO DETERMINE THE EARNINGS  
OF THE COMPANY, THE FAIR VALUE OF  
THE COMPANY FOR RATEMAKING  
PURPOSES, AND TO INCREASE  
RESIDENTIAL RATES AS NECESSARY TO  
COMPENSATE FOR THE RATE IMPACTS OF  
THE FCC'S USF/ICC TRANSFORMATION  
ORDER

DOCKET NO. T-01072A-13-0412

APPLICATION

Arizona Corporation Commission

DOCKETED

NOV 27 2013

DOCKETED BY	
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1 Southwestern Telephone Company ("Southwestern Telephone"), an Arizona corporation,  
2 hereby applies pursuant to A.R.S. § 40-250 and the Commission's Rule R 14-2-103 for a  
3 determination of Southwestern Telephone's earnings and the fair value of its investment and  
4 requests that its residential rates be increased as necessary to compensate for the rate impacts of  
5 the Federal Communication Commission's November 18, 2011, USF/ICC Transformation Order  
6 ("USF/ICC Order").

7 **I. BACKGROUND**

8 On November 18, 2011, the Federal Communications Commission issued the USF/ICC  
9 Order. The USF/ICC Order transitions the outdated federal universal service programs and most  
10 inter-carrier compensation systems into a new Connect America Fund ("CAF"). The FCC's  
11 press release characterized the USF/ICC Order as "the most significant policy step ever taken to  
12 connect all Americans to broadband."

1 The USF/ICC Order will reduce inter-carrier compensation rates to zero by July 1, 2020,  
2 for rate of return companies, with limited recovery from customers and partial recovery from the  
3 CAF. The recovery from the CAF will phase out over time at 5% annually.

4 Southwestern Telephone is a small rate-of-return regulated Incumbent Local Exchange  
5 Carrier ("ILEC"). Of particular importance to Southwestern Telephone and other rural ILECs,  
6 the USF/ICC Order adds new rules that will reduce federal high-cost loop support to carriers by  
7 the amount their flat-rate residential local service rates fall below a specified annual urban rate  
8 floor.<sup>1</sup> The rate floor includes, if any, state subscriber line charges, state universal service fees,  
9 and mandatory extended area service charges. The FCC's order established local residential rate  
10 floors of \$10.00 as of June 1, 2012, and \$14.00 as of June 1, 2013, with the floor thereafter being  
11 determined annually by the FCC's Wireline Competition Bureau, based on a nationwide  
12 average.<sup>2</sup>

13 The Wireline Competition Bureau has not yet determined the rate floor to be in effect for  
14 June 1, 2014. The nationwide residential average rate was \$15.62 in 2008. Estimates for the  
15 2013 nationwide residential average rate range from \$17.00 to \$18.50, so the 2014 rate floor will  
16 certainly be substantially higher than 2013's \$14.00 rate floor.

17 Federal and state support funding are vital to a robust telecommunications network in  
18 high cost areas. To maintain federal loop support, Southwestern Telephone and other rural  
19 ILECs must increase local rates to the FCC-mandated residential rate floors. Otherwise, the  
20 amount of federal support funds will be reduced dollar-for-dollar for each customer by the  
21 difference between the existing local rate and the new rate floor. If local rates are not increased,  
22 the new FCC rules will reduce funds coming to the state of Arizona and negatively impact  
23 customers living in high-cost areas in the state.

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<sup>1</sup> 41 C.F.R § 54.318.

<sup>2</sup> USF/ICC Order paragraph 236 states the most recently available nationwide average local rate from 2008 was \$15.62.

1 Low customer density makes Southwestern Telephone dependent on high-cost federal  
2 support mechanisms. It is important that the company be allowed to increase local rates to the  
3 FCC determined annual rate floors in order to maintain its existing federal support.

4 The Wireline Competition Bureau is not expected to set the 2014 rate floor until the end  
5 of this quarter or the first quarter of 2014. If the rate floor is not set until 2014, it could be  
6 difficult for the Commission to timely review an application and authorize new rates for  
7 Southwestern Telephone by June 1, 2014. This would cause Southwestern Telephone to lose  
8 federal high-cost loop support dollar-for-dollar by the amount the new rate floor exceeds current  
9 \$14 residential rates.

10 To prevent the loss of federal support, Southwestern Telephone requests that the  
11 Commission approve a local residential rate increase of up to \$19.00. The actual rate  
12 implemented would be set at the lower of the approved 2014 residential rate floor and \$19.00.  
13 Southwestern Telephone will file the new FCC rate floor as soon as it is available.

## 14 **II. SOUTHWESTERN TELEPHONE**

15 Southwestern Telephone Company is a corporation duly organized and existing under  
16 and by virtue of the laws of the State of Arizona. Southwestern Telephone is authorized to  
17 engage in and is now engaged in the conduct of a general communications business within the  
18 State of Arizona.

## 19 **III. SUMMARY OF REQUEST**

20 This application is made pursuant to the provisions of A.R.S. §§ 40-250 and 40-367, and  
21 Commission Rule R14-2-103. The Commission last considered Southwestern Telephone's rates  
22 in Docket No. T-01072A-12-0472, which resulted in Commission Decision 73874 issued on  
23 May 8, 2013. Decision No. 73874 authorized Southwestern Telephone to raise its residential  
24 one-party rates to \$14.00/month, effective June 1, 2013. As discussed above, these rates are  
25 substantially below the expected federal rate floor that will go into effect on June 1, 2014.

26 Southwestern Telephone is aware that many parties, including the Commission, have  
27 appealed the USF/ICC Order. However, in the meantime, Southwestern Telephone and other

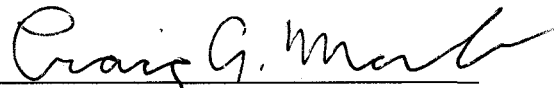
1 rural ILECS must comply with all provisions of the USF/ICC Order and will remain subject to  
2 the increased local residential rate floors and the corresponding losses of federal support funds.

3 Southwestern Telephone's loss of federal support funds would be particularly difficult to  
4 bear. As the attached schedules demonstrate, Southwestern Telephone's return on investment is  
5 negative at current rates. Put another way, Southwestern Telephone's jurisdictional earnings are  
6 negative. Losing federal support funds will only drive earnings deeper into the red.

7 In connection with this application, Southwestern Telephone has filed exhibits which  
8 include a schedule of the specific rate changes requested and the impact of the revenue generated  
9 on the company's financial position. Southwestern Telephone asks that the Commission  
10 determine the fair value of the company's investments for ratemaking purposes and stipulates to  
11 use original cost less depreciation for those purposes. Because the next opportunity to affect  
12 federal support funds is June 1, 2014, Southwestern Telephone further asks that the Commission  
13 approve a local residential rate of up to \$19.00. At \$19.00, Southwestern Telephone's return on  
14 rate base would only be 1.0%. The actual rate implemented would be set at the lower of the  
15 approved 2014 residential rate floor and \$19.00, so the actual return on rate base would be less  
16 than or equal to 1.0%. Southwestern Telephone asks that the customer notice issued by the  
17 Hearing Division inform customers of this potential range of rate increases.

18 To facilitate processing of this application, Southwestern Telephone also asks that the  
19 Commission waive any provisions of Commission Rule R14-2-103 not required by the Arizona  
20 Constitution and laws.

1 Respectfully submitted on November 27, 2013.

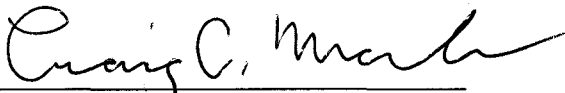
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**Original** and 13 copies **filed**  
on November 27, 2013, with:

Docket Control  
Arizona Corporation Commission  
1200 West Washington  
Phoenix, Arizona 85007

By:

  
Craig A. Marks

# **Southwestern Telephone Company**

Streamlined filing to support residential rate increase due to FCC

floor implementation and resulting HCL loss.

November 15, 2013

# Southwestern Telephone Company

November 15, 2013

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# Southwestern Telephone Company

November 15, 2013

REGULATED RESULTS OF OPERATIONS FOR TWELVE MONTHS ENDING JUNE 30, 2013  
REFLECTS CHANGES EFFECTIVE WITH ARC AND CAF IMPLEMENTATION – YEAR 2

	TOTAL TELEPHONE OPERATIONS	ADJUSTMENTS	Ref	ADJUSTED RESULTS	INTERSTATE	INTRASTATE
	(a)	(b)	(c)	(d)	(e)	(f)
1 Local	696,697	-1,663 #7	695,034	0	695,034	
2 Universal Service Fund (USF-HCL)	453,594	-67,851 #5,6	385,743	0	385,743	
		#12,3				
3 Access Revenues	1,680,585	-31,829 4,6,7	1,648,756	1,158,381	490,375	
4 Billing & Collecting	30,135	-78 #8	30,057	12,474	17,583	
5 Other Misc., Uncollectibles	81,523		81,523	31,364	50,159	
6 Total Operating Revenues	2,942,534	-101,421	2,841,113	1,202,219	1,638,894	
7 Plant Specific Expenses	592,733	41,420 #10	634,153	269,114	365,039	
8 Plant Nonspecific Expenses	260,364	16,969 #7,10	277,333	147,828	129,505	
9 Depreciation & Amortization Expenses	933,069	96,223 #10	1,029,292	415,777	613,515	
10 Customer Operations Expenses	307,124	14,169 #9,10	321,293	111,003	210,290	
11 Corporate Operations Expenses	398,991	22,242 #10	421,233	143,731	277,502	
12 Other Operating Taxes and (Income)	54,167	112,255 #9,10	166,422	72,011	94,411	
13 Nonregulated Adjustment (Part 69 WBI)		-290,597 #10	-290,597	-290,597	0	
14 Total Operating Expenses	2,546,448	12,681	2,559,129	868,867	1,690,262	
15 OPERATING RETURN BEFORE TAXES	396,086	-114,102	281,984	333,352	-51,368	
16 State Income Taxes (SIT) (6.97%)	26,919	-7,265 #11	19,654	23,235	-3,580	
17 Federal Income Taxes (FIT) (35%)	130,482	-38,667 #11	91,815	108,541	-16,726	
18 Total Operating Income Taxes	157,401	-45,931	111,470	131,776	-20,306	
19 Total Expenses and Income Taxes	2,703,849	-33,250	2,670,599	1,000,643	1,669,956	
20 Net Operating Income	238,685	-68,171	170,514	201,576	-31,062	
21 Total Year-End Rate Base	3,504,514	0	3,504,514	1,366,096	2,138,418	
22 Return on Rate Base (Ln 20 / Ln 21)					-1.5%	
23 Estimated Revenue from Local Rate Increase					87,360	
24 State Income Taxes (SIT) (6.97%)					6,089	
25 Federal Income Taxes (FIT) (35%)					28,445	
26 Increase in Net Operating Income					52,826	
27 Net Operating Income After Increase (Ln 20 + Ln 26)					21,764	
28 Return on Rate Base After Increase (Ln27 / Ln21)					1.0%	

## ASSUMPTIONS

Used 2012 Cost Study run dated 07/18/2013 for Part 36 separation of expenses.  
Separated results based upon frozen 2000 traffic factors  
Separated results based upon 6/30/2013 financials, interstate rules, adjusted for Part 64 activities  
Working Capital included for all jurisdictions



**Southwestern Telephone Company**  
**Adjustments to Revenues and Expenses**

Ref	Account	Description	Debit	Credit
1.	5082200	Access Revenues		817
	5083000	Access Revenues		196
	Exclude		1,013	
	To remove prior period (2009) interstate revenue requirement adj.			
2.	5082200	Access Revenues	642	
	5083000	Access Revenues	144	
	Exclude			786
	To remove prior period (2010) interstate revenue requirement adj.			
3.	5082100	Access Revenues	12,219	
	5082200	Access Revenues		12,546
	5083000	Access Revenues	3,721	
	Exclude			3,394
	To remove prior period (2011) interstate cost study true-up.			
4.	5082200	Access Revenues		5,614
	5083000	Access Revenues		2,275
	Exclude		7,889	
	To remove prior period (2011) interstate revenue requirement adj.			
5.	5082110	Universal Service Fund	64,317	
	K&M			64,317
	To adjust for Federal HCL projected change for 2013.			
6.	5082110	Universal Service Fund	3,534	
	5082100	Access Revenues		183
	5082200	Access Revenues		558
	PPA			2,793
	To remove prior period HCL/LSS/ICLS revenues.			
7.	5001000	Local Revenues	1,663	
	5082200	Access Revenues	14,282	
	5084220	Access Revenues	23,010	
	6540010	Plant Nonspecific Exp		655
	Exclude			38,300
	Year 2 FCC Order ICC intrastate and interstate revenue and expense reductions.			
8.	5270100	Interstate B&C	78	
	PPA			78
	To remove prior period adjustment.			

**Southwestern Telephone Company**  
**Adjustments to Revenues and Expenses**

Ref	Account	Description	Debit	Credit
9.	6623304	Customer Operations Exp		22
	7240200	Other Operating Taxes	568	
	7240300	Other Operating Taxes	49	
	7240900	Other Operating Taxes	12,741	
	PPA			13,336
	To remove prior period adjustments.			
10.	6112004	Plant Specific Exp	1,350	
	6121004	Plant Specific Exp	9,409	
	6232004	Plant Specific Exp	24,892	
	6423004	Plant Specific Exp	5,769	
	6532004	Plant Nonspecific Exp	17,624	
	6561000	Depreciation Exp	96,223	
	6611004	Customer Operations Exp	11,752	
	6623304	Customer Operations Exp	2,439	
	6728904	Corporate Operations Exp	22,242	
	7130000	Other Operating Income	94,113	
	7240900	Other Operating Taxes	4,784	
	7990000	Nonregulated Exp		290,597
	To reverse transfer of estimated Part 69 interstate expenses for WBI (Internet) to enable proper Part 36 allocation of total company expenses.			
11.	7220000	Federal Income Tax		38,667
	7230020	State Income Tax		7,265
	PPA		45,931	
	Adjust income taxes to remove prior period amounts and for adjustments to results.			

**Southwestern Telephone Company**  
Year 2 Estimated ICC Impact of FCC Order

Base Line of Eligible Recovery:

	Total	Reduction	
Interstate SWA (Includes LSS)	300,681	(14,282)	Access Revenue Interstate
Intrastate Terminating Access	475,081	(23,010)	Access Revenue Intrastate Access
Recip Comp Revenue	35,016	(1,663)	Local Revenue Intrastate Local
Recip Comp Expense	(13,789)	655	Plant Non-Specific Intrastate Local
Total Base of Eligible Recovery	796,989	(38,300)	
		AJE #7	

**Southwestern Telephone Company**

Rate Base

As June 30, 2013

	Total Company	INTERSTATE	INTRASTATE
Plant in Service	\$ 18,462,869	\$ 7,892,320	\$ 10,570,549
Accumulated Depreciation	(14,544,450)	(6,324,721)	(8,219,729)
Net Plant in Service	\$ 3,918,419	\$ 1,567,599	\$ 2,350,820
Plant Under Construction	20,587	8,757	11,830
Material & Supplies	118,826	34,484	84,342
Deferred Income Taxes	(690,039)	(293,463)	(396,576)
Cash Working Capital	136,721	48,719	88,002
Rate Base	\$ 3,504,514	\$ 1,366,096	\$ 2,138,418

**Southwestern Telephone Company**  
**For Twelve Ending June 30, 2013**

**CALCULATION OF CASH WORKING CAPITAL (CWC)**

CASH OPERATING EXPENSES	<u>Total Company</u>	<u>INTERSTATE</u>	<u>INTRASTATE</u>
Total Operating Expenses	\$ 2,559,129	\$ 868,867	\$ 1,690,262
Depreciation & Amortization	1,029,292	415,777	613,515
Cash Operating Federal Income Taxes	91,815	108,541	(16,726)
Cash Operating State & Local Taxes	19,654	23,235	(3,580)
Total Cash Operating Expenses	\$ 1,641,307	\$ 584,866	\$ 1,056,441
% LAG (30 days)	8.33%	8.33%	8.33%
TOTAL CASH WORKING CAPITAL	<u>\$ 136,721</u>	<u>\$ 48,719</u>	<u>\$ 88,002</u>

# Southwestern Telephone Company

## Proposed Rate Design

June 30, 2013 TTM Average Units\*

(A)	(B)	(C)	(D)	(E)	(F)	(G)	(H)
Service Description	Average Units <sup>(a)</sup>	Current Rates	2011 Annual Revenues	Proposed Rates	Proposed Revenues	Proposed Change Revenue	Proposed Change Percent
<b>Basic Service</b>							
Residence One-Party	1,456	\$ 14.00	\$ 244,608	\$ 19.00	\$ 331,968	\$ 87,360	35.71%
Residence Two-Party	-	\$ -	\$ -	\$ 19.00	\$ -	\$ -	-
<b>Estimated Revenue from Local Rate Increase</b>						<b>\$ 87,360</b>	

### Notes:

\*Average units are used to capture seasonal fluctuations.

(a) No reduction made for line loss.

Residential Lines													
Year	Type	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
2009	One-Party	2,916	2,982	2,964	2,492	1,759	1,556	1,481	1,443	1,449	1,609	2,179	2,498
2009	Two-Party	5	5	4	4	4	4	4	4	4	4	4	4
2009 Total		2,921	2,987	2,968	2,496	1,763	1,560	1,485	1,447	1,453	1,613	2,183	2,502
2010	One-Party	2,613	2,667	2,647	2,249	1,584	1,425	1,345	1,320	1,338	1,473	1,989	2,234
2010	Two-Party	4	4	4	4	4	4	4	4	4	2	2	2
2010 Total		2,617	2,671	2,651	2,253	1,588	1,429	1,349	1,324	1,342	1,475	1,991	2,236
2011	One-Party	2,317	2,376	2,343	2,033	1,501	1,324	1,242	1,225	1,223	1,339	1,752	1,984
2011	Two-Party	2	2	2	2	2	2	2	2	2	2	2	2
2011 Total		2,319	2,378	2,345	2,035	1,503	1,326	1,244	1,227	1,225	1,341	1,754	1,986
2012	One-Party	2,066	2,095	2,067	1,798	1,363	1,208	1,144	1,128	1,119	1,216	1,562	1,768
2012	Two-Party	2	2	2	2	2	2	2	2	2	2	2	2
2012 Total		2,068	2,097	2,069	1,800	1,365	1,210	1,146	1,130	1,121	1,218	1,564	1,770
2013	One-Party	1,823	1,884	1,854	1,600	1,248	1,125						
2013	Two-Party	-	-	-	-	-	-						
2013 Total		1,823	1,884	1,854	1,600	1,248	1,125						